

1
2 UNITED STATES BANKRUPTCY COURT
3 SOUTHERN DISTRICT OF NEW YORK
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6 In the Matter

7 of

Case No.
04-17324

8 LIONEL LLC., et al

Debtor.

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9
10 August 9, 2005

11 United States Custom House

One Bowling Green

12 New York, New York 10004

13 Fee applications, Motion to purchase tooling
14 manufactured and owned by Sanda Kan Industrial,
15 Ltd., Weiser, LLP- Fee application, K-Line
Electric Trains Inc., MDK Inc., Maury Klein,
Robert Grubba (cc) Orderto Show Cause for
Preliminary Injunction.

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17 B E F O R E:

HON. BURTON R. LIFLAND,

Bankruptcy Judge.
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1 LIONEL, LLC
2 A P P E A R A N C E S:
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8 BY: ADAM C. HARRIS, ESQ.

9 -and-

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9 New York, New York 10022

10 BY: ROBERT D. RAICHT, ESQ.

-and-

11 ALAN D. HALPERIN, ESQ.
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1 LIONEL, LLC

2 P R O C E E D I N G S

3 MR. HARRIS: Adam Harris, O'Melveny
4 and Myers on behalf of Lionel, LLC and its
5 affiliates, its debtors and debtors in
6 possession.

7 Your Honor, we have several matters
8 on the calendar this morning. Two of the
9 matters were originally scheduled, which was
10 the fees application of Chadbourne Parke and
11 Weiser I believe have been adjourned to another
12 date, so they are not on for this morning.

13 I think that was done as a result of
14 Miss Leonard being on vacation this week and
15 the issue they may have in the U.S. Trustee's
16 office. We do have three other matters.

17 THE COURT: What issues? I see the
18 U.S. Trustee's replies. It only deals with
19 what we euphemistically called a holdback, is
20 that an issue?

21 MR. WALSH: Your Honor, if I may.

22 THE COURT: I don't mind adjourning
23 it but usually lawyers are really hot to trot
24 when it comes to fee applications.

25 MR. WALSH: My understanding there

1 LIONEL, LLC

2 are no issues. They have a consent order with
3 Miss Leonard. I think they were just seeking
4 to present it to your Honor. I can speak with
5 them and have them send it to your chambers, if
6 that's okay.

7 THE COURT: I am not an advocate for
8 them here. If you're putting it over, it is
9 okay with me.

10 MR. HARRIS: Your Honor, we are
11 going to put it over because they are not here
12 and I'm not purporting to speak for either
13 Chadbourne or Weiser to say they are not here.

14 If there are no issues remaining,
15 they are submitting an agreed order to the
16 chambers signed by the U.S. Trustee's office
17 and as far as we are concerned that would
18 resolve the matter.

19 We do have three other matters on
20 other than the preliminary injunction hearing
21 this morning.

22 One is the first interim application
23 of O'Melveny and Myers. Second is the second
24 interim of Dykema and Gossett and the third is
25 the debtor's motion for approval of certain

1 LIONEL, LLC

2 critical vendors payment to Sanda Kan.

3 Is there any particular order in
4 which your Honor would take them?

5 THE COURT: No.

6 MR. HARRIS: In this case, why don't
7 I turn the podium to Miss Walsh to present the
8 matters on Dykema and Sanda Kan and I will take
9 it up on O'Melveny's application.

10 MR. WALSH: Good morning, your
11 Honor. The first matter, the Dykema first
12 interim fee application, there was an objection
13 by the U.S. Trustee. I think Alicia, Miss
14 Leonard, is on vacation this week but she and I
15 did come to resolve the objection and we have a
16 consent order which I have here for you today.
17 If I may submit it.

18 THE COURT: I will entertain it.

19 MR. WALSH: As you may remember, at
20 this end of April we filed a motion to approve
21 certain critical payments to Sanda Kan
22 Industrial, Ltd., the largest manufacturer of
23 inventory for Lionel.

24 We sought this relief in order to
25 maintain our relationship with Sanda Kan and

LIONEL, LLC

because they informed us that based on the size of their prepetition claim they would be unable to maintain the payment terms that we had been operating under for the past year or so, which was pay cash in advance of shipments and they were considering changing that to a cash in advance of order or require us to post substantial amount of security for any orders that we placed.

Furthermore, they weren't sure they would commit to maintain the level of manufacturing they were doing for us and currently they are doing 80 percent of our inventory manufacturing.

As a result of this, we negotiated in good faith with them and came up with the requested relief. We submitted the motion.

Shortly thereafter the formally disbanded Creditors Committee was reconstituted. They informed us that they had some objections to the relief requested and we adjourned this hearing for several times over the past few months to allow for negotiation between Lionel, the Creditors Committee and

1 LIONEL, LLC

2 Sanda Kan.

3 As a result of those good faith
4 negotiations, the parties have agreed to a
5 revised form of relief and, actually, if you
6 would like, your Honor, I can back you through
7 the differences between what we originally
8 proposed in our motion and what we are hoping
9 to submit here today.

10 THE COURT: Please.

11 MS. WALSH: Initially we proposed to
12 say Sanda Kan \$4.7 million out of their \$6.7
13 million prepetition claim. In exchange for
14 that, we would get \$5 million of unsecured
15 postpetition trade credit from Lionel.

16 The primary difference in this new
17 order is that Sanda Kan will receive
18 two-and-a-half million dollars of payment
19 spread out about three to four weeks. In
20 exchange Lionel will receive two-and-a-half
21 million dollars of unsecured post-petition
22 trade credit. So we see this as a vast
23 improvement. It is \$2 million, more than \$2
24 million saving to the estate in cash right
25 now.

1 LIONEL, LLC

2 In addition, the Creditors Committee
3 has negotiated to also include in this order
4 certain other provisions that are beneficial to
5 the company.

6 For instance, upon payment in full
7 of the two-and-a-half million dollars in credit
8 in inventory payments, Sanda Kan will have
9 deemed to confirm and acknowledge the debtors
10 will hold title to all tooling inventory in
11 Sanda Kan's possession and control other than
12 new tooling that's currently being proposed by
13 Sanda Kan and don't yet hold title to.

14 Furthermore, they would have been
15 deemed to consented to Lionel's removal of any
16 of the inventory or goods in Sanda Kan's
17 possession at any time in the future and Sanda
18 Kan would have warranted that they will make
19 all payments required to be made by its
20 creditors and any other entity they may deal
21 with in China where their factories are to
22 avoid any of those entities asserting a lien on
23 Lionel's property that is in Sanda Kan's
24 possession.

25 The order further provides that

1 LIONEL, LLC

2 Sanda Kan agrees that the debtor is under no
3 obligation to maintain the current level of
4 production with Sanda Kan and that Lionel
5 agrees to indemnify Sanda Kan for any costs
6 that may be incurred if we do pick up to move
7 our tooling somewhere outside Sanda Kan's
8 facility.

9 Sanda Kan agrees to submit to the
10 jurisdiction of this court for any and all
11 matters that may arise out of this order,
12 including any negotiations regarding security
13 that Lionel might have to post to Sanda Kan to
14 cover any such costs that might arise with the
15 moving of the tooling.

16 Debtors believe that this relief is
17 in the best interest of their estate, first of
18 all, because this revised order is definitely
19 more favorable than the original request
20 requested. It will preserve our relationship
21 with absolute critical inventory that provides
22 80 percent of our inventory. It will enable us
23 to obtain two-and-a-half million dollars of
24 unsecured post-petition trade credit as soon as
25 two-and-a-half million dollars of critical

1 LIONEL, LLC

2 vendor payments are paid in full which credit
3 will continue for as long as these Chapter 11
4 cases as long as there is no material adverse
5 change in our business.

6 Furthermore, Sanda Kan is also
7 waiving approximately \$95,000 of its remaining
8 prepetition claim which is a portion of its
9 claim for prepetition interest on the
10 prepetition claim.

11 I think that pretty accurately
12 summarizes it. I would also like to say in
13 addition to the order being signed by Sanda
14 Kan, the Creditors Committee and the debtors,
15 it has been reviewed by both counsel to both of
16 our post-petition lenders and they have
17 consented to the relief as well.

18 THE COURT: Does anyone want to be
19 heard?

20 MR. RAICHT: Yes, your Honor. On
21 behalf of the Creditors Committee, I would just
22 -- Bob Raicht, Halperin Battaglia Raicht,
23 counsel for the Creditors Committee.

24 As noted, we did have some concerns
25 at the outset regarding the motion. Basically,

1 LIONEL, LLC

2 the Committee was concerned that there was
3 significant consideration going out the door
4 and we weren't sure that the estates were
5 getting sufficient benefit for that.

6 Those payments -- we are also faced
7 with the idea the payments were being made to
8 an entity that is located in the Peoples
9 Republic of China and beyond the jurisdiction
10 of this court.

11 I will say that when we expressed
12 these concerns to both the debtors and Sanda
13 Kan, they were very cooperative to try to allay
14 and address our concerns.

15 I can report we asked and received
16 on a voluntary basis significant discovery
17 regarding underpinnings for proposed payments,
18 some scenarios as to what the financial impact
19 would have been upon the debtor were Sanda Kan
20 taking certain actions that they thought were
21 possible, as well as other information we
22 requested. So we are very happy with the
23 amount of cooperation we received.

24 Thereafter for about a period of
25 three months the Creditors Committee engaged in

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LIONEL, LLC

direct negotiations with Sanda Kan regarding the terms of an order we would find acceptable. I will also report the Committee was involved in every aspect of the negotiations on almost a daily basis. I won't go over the accommodations that Miss Walsh described.

Yes, it is a reduction in the amount from the 5.7 to 2.5. The other considerations are the liens, the ability to remove the tooling and inventory, the ability to not be required to maintain any particular levels of production are important in this case.

We don't know what the end game is and I think it is important to have that kind of flexibility built in this kind of projects.

There was a statement that the jurisdiction was agreed to by Sanda Kan with protection of the motion. I think it is a broader consent to jurisdiction. I don't know whether Sanda Kan filed a proof of claim or not but whatever the jurisdiction that's conferred by filing of the proof of claim is what I understand they agreed in terms of the order.

1 LIONEL, LLC

2 Again, I would say this order does
3 reflect unanimous consent of the Creditors
4 Committee. This has been a good thing for the
5 estate.

6 I think, in any event, I can't say
7 what has happened before the case or what will
8 happen afterwards, but I think this was one
9 where everybody worked together to try to
10 preserve the business and benefit of the
11 estate, so we support the motion.

12 THE COURT: Does anybody else want
13 to be heard?

14 MS. KEYNES: Jocelyn Keynes from
15 Stevens and Lee representing Mike's Train
16 House, one of the debtor's main competitors and
17 largest general unsecured creditor.

18 We just wanted to make a brief
19 statement. We also support the settlement and
20 we believe that the Creditors Committee and its
21 professionals did an excellent job.

22 MR. ABRAMOWITZ: Steven Abramowitz,
23 Vinson and Elkins on behalf of Sanda Kan. I
24 would like to reiterate on behalf of what
25 everyone stated on the record we did, indeed,

1 LIONEL, LLC
2 file a proof of claim which is, of course,
3 modified by the relief granted in this order
4 and we did, indeed, confer that in the
5 jurisdiction that would come with the filing of
6 the proof of claim.

7 MR. CHAISANGUANTHUM: Mike
8 Chaisanguanthum, Weil Gotshal on behalf of the
9 United Partners. We would just like to echo
10 Miss Walsh's comments and add that we also
11 support the motion.

12 THE COURT: I'll approve the
13 programming and entertain the order.

14 MR. WALSH: May I approach with the
15 Dykeman and this order.

16 THE COURT: I have approved each of
17 the orders.

18 MR. HARRIS: Your Honor, the third
19 matter we have on this morning is the first
20 interim application for allowance of
21 compensation and reimbursement of the expenses
22 for O'Melveny and Myers, LLP as counsel to the
23 debtors in this case.

24 Your Honor, we filed our first
25 interim fee application covering the time

1 LIONEL, LLC

2 period from the filing date, which was November
3 15, 2004 through March 31, 2005, for a
4 four-and-a-half month period seeking payments
5 of fees in the aggregate amount of \$1,597,133
6 and 76 cents and expenses reimbursement of
7 expenses in the aggregate amount of \$80,303 and
8 six cents.

9 Your Honor, in accordance with this
10 Court's prior order authorizing payment of
11 monthly compensation, O'Melveny and Myers has
12 been paid in the aggregate approximately 1.4
13 million, which has been allocated 100 percent
14 to expenses in the first instance and then
15 representing what is approximately 80 percent
16 of the fees incurred to date continuing the 20
17 percent holdback provided by that order, which
18 we confirm was continuing.

19 We're not asking for a catchup at
20 this point in time, which is one of the issues
21 raised in the U.S. Trustee's amended objection.

22 There were no objections submitted
23 or responses submitted to any of our monthly
24 statements, which were distributed and served
25 in accordance with the Court's order, and other

1 LIONEL, LLC

2 than the amended objection of the U.S.
3 Trustee's office, no objections were filed to
4 the first interim application.

5 The U.S. Trustee's office, your
6 Honor, did file an amended objection raising
7 what were essentially four issues.

8 First, your Honor, was the question
9 of whether O'Melveny was seeking to be paid the
10 20 percent holdback at this point in time and I
11 already confirmed and again will confirm we are
12 not seeking to do that at this point in time.

13 The U.S. Trustee raised certain
14 issues with respect to fees which they thought
15 were more timekeeper were more clerical in
16 nature in the amount of approximately, let's
17 see, \$ 5,582, which we have agreed to write-off
18 and deduct from the residual holdback amount.

19 The U.S. Trustee's office also noted
20 with respect to nonworking travel of one of our
21 attorneys, we had inadvertently billed that
22 time at 100 percent rather than 50 percent and
23 representing another \$4,987 and 50 cents, which
24 we have also agreed obviously to take off, your
25 Honor.

1 LIONEL, LLC

2 And then the last objection of the
3 U.S. Trustee, which I think was more the nature
4 of a shout across by bow then it was a
5 substantive objection had to do with the
6 lumping of time entries of some of the
7 professionals at O'Melveny and Myers who are
8 not as familiar with the rules of the court
9 with respect to the level of detail required
10 for their time entries and the U.S. Trustee has
11 agreed not to pursue that in connection with
12 this particular application but deemed me
13 forewarned with respect to any future
14 application we may file and we have sent around
15 appropriate notice to all the attorneys
16 internally to make sure they are much more
17 attentive to their timekeeping going forward,
18 so certainly that issue will not raise its head
19 again in this case.

20 With those changes, your Honor, we
21 would ask that the Court approve our first
22 interim application.

23 We can submit an order later today
24 with the necessary changes setting forth the
25 actual residual holdback amounts based upon the

1 LIONEL, LLC

2 agreement with reached with U.S. trustee.

3 I would be happy to answer any
4 questions your Honor may have.

5 THE COURT: Does anybody want to be
6 heard? The request for compensation as
7 modified by this record is granted. Submit the
8 order.

9 MR. HARRIS: Thank you, very much,
10 your Honor. Your Honor, at this time, I would
11 like to take care of one quick housekeeping
12 matter relative to the preliminary injunction
13 hearing and I think we would ask the court to
14 give us basically 10 minutes so we can set up
15 the exhibit easels and things like that and get
16 ready to get started.

17 The housekeeping matter, your Honor,
18 I would like to move the admission pro hoc vice
19 of two of my colleagues who are residents in
20 O'Melveny and Myers California's offices.
21 David Enzminger and Ryan Yagura.

22 Mr. Enzminger is admitted to
23 practice in the Northern, Southern, Eastern and
24 Central Districts of California as well as the
25 district of Arizona.

1 LIONEL, LLC

2 Mr. Yagura is admitted to practice
3 in the Northern, Southern and Central Districts
4 of California as well as the Federal Circuit.
5 They are both in good standing in connection
6 with each of these admissions and we would
7 request the Court authorize their admission pro
8 hoc vice for purposes of the proceeding today.

9 We will pay the fee associated with
10 each of those to the appropriate authorities.

11 THE COURT: Will that be an expense
12 that will show up on your fee applications?

13 MR. HARRIS: I think the \$50 will be
14 gratis to O'Melveny and Myers, your Honor.

15 THE COURT: Your application is
16 granted.

17 MR. HARRIS: Thank you, your Honor.
18 If your Honor will give us 10 minutes so we can
19 set and up round up all the players.

20 (A break from the record was taken
21 at this time.)

22 MR. HARRIS: Your Honor, thank you
23 so much for your patience and indulgence while
24 the parties have been conferring.

25 I believe that we have reached an

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LIONEL, LLC

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agreement with K-Line that will resolve the

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matters extant in the adversary proceeding or

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was the subject of this morning' s preliminary

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injunction hearing. Your Honor, I would

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respectfully turn the podium over to my

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colleague, Dale Cendali to present the terms of

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that agreement and at the conclusion of which

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we are going to ask obviously K-Line's counsel

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to confirm their agreement with those terms and

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we would probably ask that you so order the

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record so that what we agreed to here today

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will, in effect, be binding on all parties.

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We will formally document it

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afterwards but we want to have the record with

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that as well so with that let me turn the

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podium over to Miss Cendali.

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MS. CENDALI: Thank you, your

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Honor. I second my partner's appreciation to

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this court for giving the parties a chance to

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talk.

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The parties have entered into an

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agreement to settle this case. The provisions

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of which are as follows: The defendants will

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agree to the entry of a permanent injunction on

1 LIONEL, LLC
2 consent which will enjoin them from making or
3 selling any products containing Lionel
4 technology at issue in this case, specifically
5 the case sounds MDK 089 product, the MDK 0956
6 transformer product and the MDK 090 cruise
7 control product. That the injunction though
8 will not go into effect until January 31st of
9 2006.

10 This does not affect any previously
11 existing licensing agreements that may exist
12 between the parties.

13 In the consent judgment, as I state
14 today, it will also detail the acknowledgement
15 of the parties that Mr. Pierson was
16 inappropriately hired by K-Line; that Lionel
17 technology was used without Lionel's
18 permission; that Lionel technology was, in
19 fact, used in K-Line's products and that the
20 technology is owned by Lionel and that K-Line
21 has no right, title and interest in that
22 technology other than pursuant to their right
23 to continue sales through January 31st of 2006
24 as provided in the settlement.

25 In addition, K-Line will execute

1 LIONEL, LLC
2 appropriate documentation to confirm and to
3 clarify that this technology is Lionel and will
4 execute in particular assignment agreements to
5 make sure that any right, title and interest
6 they might have previously claimed are now the
7 property of Lionel.

8 In terms of financial terms, K-Line
9 will pay Lionel a 5 percent royalty on all
10 sales of products containing Lionel's
11 technology in these products for the year 2005
12 through January 31, 2006.

13 Such obligation will be audited.
14 K-Line will provide weekly financial statements
15 issued no later than the Wednesday of each week
16 with respect to sales completed by Friday of
17 the previous week.

18 With respect to royalties due from
19 sales from January 31, 2005 through today,
20 K-line will provide within one week a financial
21 statement indicating what royalties are due and
22 owing, and they will pay by November 1 what
23 they currently estimate that to be,
24 approximately \$50,000 and they will pay the
25 first half of that sum on November 1st or by

1 LIONEL, LLC

2 November 1st, excuse me.

3 The royalties begin as of January 1,
4 2005, not January 31, 2005. So the license
5 period in effect is January 1, 2005 through
6 January 31, 2006, so it is a 13 month period,
7 which happens to coincide with the end of
8 K-Line's fiscal year for this coming year.
9 They will pay the second half of the amount due
10 pursuant to the royalty on for past due
11 royalties, in other words, for royalties up
12 through today by January 31, 2006.

13 In addition, K-Line will execute and
14 deliver to Lionel a promissory note to
15 reimburse Lionel's for its attorney fees,
16 out-of-pocket costs and expenses incurred in
17 connection with the investigation and
18 prosecution of this adversary proceeding to the
19 sum of what those actual fees and costs
20 actually are, but up to \$700,000.

21 Lionel will provide reasonable
22 documentation of such fees, costs and expenses
23 to K-Line subject to redaction to preserve any
24 applicable privilege where it might be
25 necessary. The promissory note will be payable

1 LIONEL, LLC

2 as follows: \$25,000 no later than September 15
3 and the remainder in equal monthly installments
4 over a seven year period with for each year an
5 equal amount paid.

6 The promissory note will be
7 personally guaranteed by each of defendant's
8 Bob Grubba and Maury Klein. Mr. Klein's
9 guarantee will be secured by a pledge of his
10 equity interest in K-Line, subordinate only to
11 the existing pledge of such interest to is an
12 today can.

13 In addition, Mr. Grubba's pledge
14 will be secured to the extent permitted by
15 applicable law of his interest to whatever
16 extent that is, in the company's Broadway
17 Trains Ltd.

18 The failure to timely make any
19 payment obligation under this agreement will
20 constitute a material default under this
21 agreement that if not cured within five
22 business days after notice is given of the
23 breach shall result in an immediate
24 acceleration of all amounts due and payable and
25 a termination of any continuing right to sell

1 LIONEL, LLC

2 products containing Lionel technology during
3 the term of the sell-off period.

4 In addition, MDK, K-Line, gives
5 Lionel a worldwide fully paid up royalty free
6 license to make, use, import, sell or offer for
7 sale under all patents and patent applications
8 relating to model train command and control,
9 including all continuations, continuations in
10 part, divisionals, et cetera, whether or not
11 filed as of the date of this agreement.

12 K-Line represents and warrants that
13 technology with regard to such patent
14 applications and prospective patent
15 applications were not derived from the
16 technology at issue in this case that had come
17 from Lionel.

18 In addition, Lionel licenses to
19 K-Line to the extent that Lionel makes any
20 similar improvement, continuation or other
21 patents building on whatever patents K-Line has
22 licensed to them that K-Line would be licensed
23 to that technology on a fully paid up royalty
24 free basis as well.

25 There will be a release, a mutual

1 LIONEL, LLC
2 release of all parties in this action with
3 respect to all matters set forth in the
4 complaint.

5 In addition, Lionel represents and
6 warrants that it has not to date contacted any
7 law enforcement authority with regard to the
8 activities alleged in the complaint.

9 In addition, the parties have agreed
10 to the extent that future disputes may arise
11 between the parties with respect to
12 misappropriation, technology and similar
13 issues, they will attempt to speak to one
14 another on an informal basis and mediate
15 informally the issues amongst themselves prior
16 to bringing any lawsuit. I believe that that
17 reflects the agreement between the parties.

18 MS. BUTERA: I believe that's true.

19 MS. CENDALI: You Honor, we
20 respectfully request that the Court so order
21 the settlement agreement in the outlines that I
22 have provided. It will be subject, outline
23 proposed and it remains in force and effect
24 until such time as the parties are able to
25 execute a fully detailed document that sets

1 LIONEL, LLC

2 forth all the Is and Ts of the agreement.

3 THE COURT: Does anyone want to be
4 heard? Before I hear from anybody, since these
5 are the terms that have been expressed by
6 counsel, there are a number of defendants that
7 are implicated in this consent judgment.

8 Mr. Klein, are you present?

9 MR. KLEIN: Yes, I am.

10 THE COURT: Will you approach.
11 Mr. Grubba, will you approach. You heard the
12 terms of the settlement on behalf of both all
13 the parties.

14 MR. KLEIN: Yes, we did.

15 MR. GRUBBA: Yes.

16 THE COURT: Do you agree with these
17 terms?

18 MR. KLEIN: Yes.

19 THE COURT: Do you understand this
20 is a judgment. You are going to be bound by
21 this judgment?

22 MR. KLEIN: Yes.

23 MR. GRUBBA: Understood.

24 THE COURT: And you agree to
25 implement the terms that have just been set

1 LIONEL, LLC

2 forth on the record?

3 MR. KLEIN: Yes, we do.

4 MR. GRUBBA: Yes.

5 THE COURT: This record is so
6 ordered.

7 MS. CENDALI: Thank you, your
8 Honor.

9 MR. HARRIS: Your Honor, I don't
10 know if you want to hear from any of the
11 parties. I think Mr. Halperin had wanted to
12 say something relative to the settlement and,
13 other than that, we have no further business
14 before the court today.

15 MR. HALPERIN: It is after 12 so I
16 guess good afternoon, your Honor. On behalf of
17 the Committee we appreciate your Honor's
18 indulgence as well.

19 I am caught a little bit by
20 surprised because my understanding was the
21 collateralization to be offered by Mr. Grubba
22 was his stock interest in Broadway Ltd. and
23 precision scale models. I'm now told it is
24 not. I will discuss that further with debtors
25 counsel.

1 LIONEL, LLC

2 Suffice to say the collateralization
3 is a material component for the Creditors
4 Committee to sign off on this deal as we
5 believe it will help ensure the payments that
6 are supposed to be made, ultimately are made
7 and we would also want some assurance to the
8 extent it is ultimately determined that one of
9 these two entities will be offered as
10 collateral. A, they are offered as
11 collateral.

12 It was some statement to be
13 permitted by law. We understand that is going
14 to be worked out and it is a material statement
15 to the Committee and B there will be no
16 shifting of assets to that entity to make it
17 one more attractive to the other to the extent
18 we only get one to the other.

19 THE COURT: I understand what you're
20 telling me. You're saying that this settlement
21 as presently couched is not in the best
22 interest?

23 MR. HALPERIN: You Honor, all I'm
24 saying I think the debtors has done a yeoman
25 job in bringing it fourth and getting a good

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2 settlement.

3 My understanding out it the hallway
4 Mr. Grubba was to offer two components as
5 collateral as his under obligation under the
6 settlement. It was Broadway Ltd. and precision
7 scale model. It was said on the record it was
8 only Broadway Ltd.

9 That came as a bit of a surprise to
10 me but I want to discuss it with counsel.

11 THE COURT: I think you're entitled
12 to clarification.

13 MS. CENDALI: They were only willing
14 to provide the collateral, to pledge with
15 regard to Broadway Ltd. and in keeping with
16 what we believe to be the best interest of the
17 estate, counsel to the debtor determined that
18 in our view that was sufficient.

19 Counsel to the creditors Committee,
20 however, given the exigencies, was not apprised
21 of that, the way that issue came out and,
22 therefore, they are raising it now.

23 MR. HALPERIN: Your Honor, I'm not
24 prepared to second guess the debtor at this
25 point as they have been integrally involved in

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2 this process and I think all and all this is a
3 good settlement for the debtor both in terms of
4 ensuring the infringing activities stopped, the
5 use of Lionel's technology stops and that there
6 is isn't remuneration to the estate.

7 Having said that, there are serious
8 wrongs that went on and I'm a little surprised
9 that someone is unwilling to offer collateral
10 as long as his obligations are met. It is not
11 an issue but if it is not that's when the
12 estate would need protection.

13 THE COURT: I share concerns as to
14 whether or not all of the terms here are in the
15 best of interest of the estate for purposes of
16 the 1990 settlement.

17 If there was an understanding with
18 the Creditors Committee by participation and
19 negotiations that certain collateral was either
20 to be utilized in connection with the
21 settlement or at least that the prospect of
22 shifting collateral so that whatever is
23 comprehended to be collateralized today is not
24 actually the result of any form of agreement, I
25 think that this should be buttoned down at this

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2 point. I will give you a five minute recess.

3 MR. HALPERIN: Thank you, your
4 Honor.

5 MS. CENDALI: Thank you, your
6 Honor.

7 THE COURT: I do wish to comment
8 about the Court's concern with respect to the
9 section of appropriately collateralizing in the
10 agreement here that essentially the conduct
11 that has led to this request for injunctive
12 procedure is an element of background and
13 history which legitimately causes the Creditors
14 Committee's concern and would cause the Court
15 concern in the context of enforceability but
16 settlement generally understand is being
17 brought before the court for approval. And I
18 would want to see that buttoned down because
19 I'm going to have to make a finding that this
20 is in the best interest of the estate.

21 MR. HALPERIN: Thank you, your
22 Honor.

23 (A break from the record was taken.)

24 MR. HALPERIN: Thank you for the
25 brief recess, your Honor. The parties have had

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2 some further discussion and I believe I state
3 this accurately in that Lionel states the
4 obligations of Mr. Grubba and the others, the
5 joint several obligation will also be
6 collateralized by Mr. Grubba's interests in
7 Broadway Ltd. and precision scale model to the
8 extent legally possible.

9 They are going to be confirming that
10 there are no impediments to granting collateral
11 interests in those equity interests,
12 shareholders agreements and the like. They
13 will confirm that for us relatively quickly.

14 If there are interests, if there are
15 impediments, we will sit down and have
16 discussion about appropriate substitute
17 collateral and demonstrate impediments and have
18 subsequent discussion about equity interests
19 that they have agreed to pledge his and his
20 family, I believe he said possibly his wife's
21 interest in both Broadway Ltd. and Precision
22 Craft, Inc. and with that modification, the
23 committee is fine with the settlement as
24 presented to the court.

25 THE COURT: Mr. Grubba and and

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2 Mr. Klein, is that your understanding that's
3 just been described on the record?

4 MR. GRUBBA: Yes.

5 MR. KLEIN: Yes.

6 THE COURT: He can't hear a head
7 shake.

8 MR. GRUBBA: Yes.

9 MR. KLEIN: Yes.

10 MR. ABRAMOWITZ: Your Honor, as an
11 abundance of caution, I'm counsel to Sanda
12 Kan. Of course I just want to make it clear
13 I'm counsel to Sanda Kan only in the capacity
14 of a creditor of Lionel.

15 I learned again Sanda Kan has
16 relationships with some of the defendants here
17 and I don't want my presence here to imply any
18 assumptions made about that or res judicata
19 effect or anything. I will obviously advise my
20 client about this.

21 THE COURT: Anyone else want to be
22 heard? Again, I repeat, this record is so
23 ordered. The basic terms and conditions are to
24 be considered enforceable, is that your
25 understanding, counsel?

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2 MS. CENDALI: Yes, your Honor.

3 MS. BUTERA: Yes, your Honor.

4 THE COURT: Mr. Klein and

5 Mr. Grubba.

6 MR. KLEIN: Yes.

7 MR. GRUBBA: Yes.

8 THE COURT: That is from this moment

9 on the injunctive features are etched in the

10 record and they are now binding.

11 MS. CENDALI: Thank you, your

12 Honor.

13 THE COURT: Thank you all.

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LIONEL, LLC
C E R T I F I C A T E

I, MICHAEL WILLIAMS, a Certified
Shorthand Reporter and Notary Public of the
State of New York do hereby certify that the
foregoing is a true and accurate transcript of
the within proceedings, to the best of my
ability.

A handwritten signature in cursive script that reads "Michael Williams". The signature is written in dark ink and is positioned above a horizontal line.

MICHAEL WILLIAMS, CSR

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UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

Minutes of ProceedingsDate: **August 9, 2005**

In re:

LIONEL L.L.C., et. AL,

Debtors,

LIONEL L.L.C.,

Plaintiff,

v.

K-LINE ELECTRIC TRAINS, INC., MDK INC.,
MAURY KLEIN, ROBERT GRUBBA

Defendants.

Case No. 04-17324(BRL)

Adv. Pro. No. 05-2337

Present: Hon. Burton R. Lifland
Bankruptcy JudgeMary Lopez
Courtroom DeputyMichael Williams
Court Reporter

Trustee _____

Counsel _____

Debtor(s) _____

Counsel _____

1. Creditor _____

Counsel _____

2. Creditor _____

Counsel _____

3. Plaintiff/Applicant _____

Counsel _____

4. Defendant/Respondent _____ Counsel _____

Proceedings: ☒ Lionel's Motion by Order to Show Cause for Injunctive Relief☐ Motion to Void Lien Held By☐ Motion by☐ Motion to Confirm/Modify Plan

Orders:

☐ Relief sought in complaint/motion:☐ Granted☐ Denied☐ Dismissed☐ Awarded by Default☒ Judgment to enter for:☒ Plaintiff☐ Defendant☐ Applicant☐ Respondent☐ In the amount of \$ _____☐ Cost in the amount of \$ _____

☒ Pursuant to the terms of the settlement as set forth on the record and so ordered at today's hearing, and injunctive relief having been agreed to and granted jointly and severally against defendants K-Line Electric Trains, Inc., MDK inc., as well as against defendants Maury Klein and Robert Grubba who are also jointly and severally liable, and pursuant to the record of the proceedings the parties have been directed to submit implementing and supplementing documentation and orders consistent with the terms of the agreed-upon settlement.

BY THE COURT

FOR THE COURT: Kathleen Farrell, Clerk

/Burton R. Lifland
United States Bankruptcy Judge1:30 p.m.
TimeAugust 9, 2005
DateBy /s/ Mary Lopez
Deputy Clerk

1
2 UNITED STATES BANKRUPTCY COURT
3 SOUTHERN DISTRICT OF NEW YORK
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5
6 In the Matter

7 of

Case No.

04-17324

8 LIONEL LLC., et al

Debtor.

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9
10 August 15, 2005

11 United States Custom House

12 One Bowling Green

13 New York, New York 10004

14 Conference Meeting

15 B E F O R E:

HON. BURTON R. LIFLAND,

Bankruptcy Judge.

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1 LIONEL, LLC
2 A P P E A R A N C E S:
3

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25

LIONEL, LLC

P R O C E E D I N G S

THE COURT: Basically, this conference was called at the request of O'Melveny pursuant to their requesting letter of August 11th. The Court's been reading with interest all the correspondence back and forth and I'll let you speak first.

MS. CENDALI: Thank you, your Honor. Dale Cendali on behalf of the debtors, Lionel Trains. We are very concerned that we are being deprived of a basic tenant of what we thought we had accomplished in the settlement.

As Lionel's press release indicated, our primary objective was to make clear to the world that they illicitly had taken Lionel's technology, advertised as their own when it was, in fact, Lionel's technology. We thus see -- and for that, we were willing to trade other kinds of consideration in order to make sure that that was clear to the world.

Instead, they issue a press release where they continue to state, among other things, to deny that the technology was really Lionel's technology.

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For example, rather than admitting that he was not hired to develop advances on Lionel technology, they tried to take the position that Mr. Pierson wasn't hired to develop advanced versions of Lionel technology even though all the documentation plainly indicates the circuitry, the software, et cetera shows that that's not only what they did, but that's what, in fact, the ungarnished undisputed truth of the matter is.

Moreover, they go so far as to take a statement from our briefs that I'm sure your Honor is aware of where we have pointed out what they have been able to do to harm Lionel was to offer our technology at cheaper prices because they didn't have to spend the years on the R and D and the money on the R and D. They were just able to get it and yet they continue to argue K-Line offers superior technology at a considerably lower price. We will maintain that leadership, thereby specifically making the point to the world, completely taking that line out of context and a complete and material breach of the settlement where they were

1 LIONEL, LLC
2 supposed to admit that they took Lionel's
3 technology; that Lionel's technology was in
4 their products and that it is Lionel's
5 technology.

6 They are continuing to spin this as
7 if K-Line had the superior technology when that
8 is manifestly not true.

9 In addition, your Honor, they
10 continue to leave out key things, such as the
11 fact that pursuant to the permanent injunction,
12 they are to no longer ever sell these products
13 ever again.

14 Instead, they say, well, K-Line will
15 continue to deliver all products with the
16 sound, speed, control and transformer
17 technology at issue and pay a royalty to Lionel
18 through January 31, 2006.

19 Nowhere in there does it say,
20 especially as artfully as the bullet point was,
21 nowhere in there does it say by the way we are
22 not going to be able to sell those products
23 anymore. We are discontinuing them.

24 It suggests that the royalty may end
25 at that point but they don't say anywhere they

1 LIONEL, LLC

2 are going to discontinue the products.

3 In fact, it goes on to suggest they
4 are already working on upgrades of the product
5 where again the whole concept of an upgrade
6 suggests, one, that they are going to be
7 continuing with the product and just coming out
8 with upgraded versions of the product, which
9 they are not allowed to do and, two, suggest
10 maybe they are going to go back and continue to
11 use our upgrade in these upgrades rather than
12 go back to square one.

13 Then they completely twist a
14 provision which was part of the agreement was
15 the idea that they mention to us that they had
16 some patents on file for control technology.

17 We don't know what those patents
18 are. We haven't seen those patents, but in the
19 course of settling the case, rather than have
20 to decide then and there show me the patents
21 and let's try to figure out whether these
22 patents had anything to do with the secret
23 information that our engineers, Mr. Pierson and
24 Mr. Grubba, took with them to your company, we
25 just said, fine. License those to us so there

1 LIONEL, LLC

2 is no issue further down the road with regard
3 to those patents.

4 Instead, they are trying to spin
5 that as the equivalent of Microsoft announces
6 that it entered into a licensing arrangement
7 with, you know, this entity to try to put them
8 in a better position of looking like they're
9 the technology leader; that maybe they just got
10 caught on some sort of minor contractual issue,
11 but, essentially, the story they are spinning
12 to the world is that they did nothing wrong.
13 Maybe there was no technical glitch because of
14 the employment contract but essentially they
15 are continuing to tell the world that it is
16 their technology; that it is superior to Lionel
17 and that's in breach of the material terms of
18 the agreement.

19 There is also on a -- everything
20 I've just said relates to breaches of the terms
21 and the statements with regard to who did what
22 to whom and whose technology it is, but there
23 is also an apparent issue of perhaps not having
24 a meeting of the minds on at least two points
25 in the sense that, as we thought was very

1 LIONEL, LLC

2 clear, that in exchange for not making them to
3 do an immediate recall they were supposed to
4 have just a limited sell-off period.

5 My comments to the report indicated
6 they won't have any other right other than to
7 sell off what they already had in stores,
8 whatever they had in inventory and instead they
9 are apparently giving the impression to the
10 marketplace that they have the ability to go
11 and manufacture and goose the market with more
12 stuff, which we would never in a million years
13 ever agreed to. This is just uncommon in trade
14 secrets in other IP cases, giving them a
15 limited sell-off of the inventory they had.

16 In addition, even though again we
17 thought it was clear that there was to be joint
18 and several liability on the part of the three
19 defendants with, as your Honor may remember, a
20 pledge of stock of the individual defendants,
21 Mr. Halperin, counsel for the Creditors
22 Committee, even referred to that specifically
23 in his part of the testimony.

24 They are not denying that there was
25 ever any agreement with regard to joint and

1 LIONEL, LLC
2 several liability, which, again, if true, shows
3 that there wasn't a meeting of the minds on
4 that material issue.

5 So the bottom line, your Honor, is,
6 you know, we wish we weren't here. We feel
7 embarrassed. We feel frustrated that we have
8 had to write to your Honor again on this issue,
9 but we felt that we had no choice in the matter
10 because we thought that the settlement that we
11 had crafted was materially breached and
12 undermined by what they have done and we are
13 thus here asking for either two potential forms
14 of relief.

15 One, that the settlement, especially
16 since there is apparently some issue as to all
17 the terms, be vacated so that we can then go
18 back to square one and schedule, either have
19 the full fledged hearing or we are prepared to
20 argue it orally right now or that there be some
21 other mechanism that the Court might construct
22 to make clear whose technology it is.

23 THE COURT: Well, they have offered
24 to publish a retraction.

25 MS. CENDALI: It would have to be a

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very clear retraction similar, I do a lot of newspaper work, too, and at this point, a retraction would have to be very clear that when we said this, that wasn't correct. What we meant to say was this or to the extent we said this, what the real truth of the matter is this.

It doesn't help to do as they are suggesting how about if we just sort of release a long list of terms and let the market maybe try to figure out what it all means.

It has to be a true retraction, as your Honor is suggesting, that really makes clear that when they say things like K-Line technology, Lionel admits that K-Line technology is superior to and cheaper than Lionel it really makes clear what's going on. That's our position.

MS. CENDALI: If I may permitted to add one thought, your Honor.

My client, Mr. Colbry, really was also very troubled beyond the specific terms and things in the press release by the overall, as he puts it, kind of unrepentant tone and

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feeling of lack of admission of doing anything wrong, and that's also extremely troubling and not what he thought he was getting.

MS. BUTERA: Thank you, your Honor. Celeste Butera and I represent the defendants.

First, your Honor, we'd like to talk about how we got here and then I will address the offer that we have placed on the table and why we have placed that offer on the table.

First, I mean, the parties had a settlement. It was read into the record. The terms are in the record for all to see. Everyone has, I think, up until this point now at least as of this point now has the terms that were read on to the record.

The press release by K-Line was issued in response to Lionel's press release and Lionel's press release had some inaccuracies contained in it that K-Line was being damaged by and wanted to rectify. They are in my letter.

The first one is that the defendants admitted that they paid Lionel's chief engineer to develop advanced versions of Lionel

1 LIONEL, LLC
2 operating systems and features that were used
3 in a number of K-Line's engines. That was, of
4 course, not an admission that was made.

5 There was, as the Court knows, a
6 specific consent judgment that the defendants
7 agreed to in exchange for the license that they
8 were getting to manufacture and sell the
9 products through January 31st.

10 THE COURT: Was this press release
11 on the part of K-Line done in consultation with
12 the law firm?

13 MS. BUTERA: Your Honor --

14 THE COURT: Maybe you don't want to
15 answer that. I don't know because I will tell
16 you right now I've been exposed to everything,
17 including what everybody else in the
18 marketplace has and the conclusion that any
19 person from Mars, including this judge, was and
20 is that that statement and the press release is
21 materially false and misleading, and, indeed,
22 it does indicate that there has been apparently
23 on some very key issues a lack of meeting of
24 the minds, and we need to know further if
25 you're still going to take the position that

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this very carefully constructed press release, which seems to evade the intent of all the parties and what the Court understood and the Creditors' Committee understood was the nature of the settlement.

If that's the case, then simply we need to go no further. If there is, indeed, a lack of the meeting of the minds I can vacate the settlement and go forward.

MS. BUTERA: Your Honor, if I may, your Honor.

There clearly is from the terms that are set forth in the transcript, there clearly is a meeting of the minds. There is no prohibition.

THE COURT: Well, there seems to have been some hidden agenda or some hidden purpose that now seems to have played itself out in the press release that came out.

Frankly, I was kind of surprised because it did make it appear to that euphemistic person from Mars that K-Line didn't do anything wrong; that there wasn't any misappropriation and that Lionel's technology

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2 was appropriately being utilized by K-Line.

3 If that's the position or the
4 intention that is intended to create, then we
5 should really go forward with the trial.

6 MS. BUTERA: Your Honor, that is
7 simply not true.

8 THE COURT: I will give you the
9 opportunity to make that point.

10 MS. BUTERA: Your Honor, that is
11 absolutely not the position of the defendants,
12 and what the defendants want the Court to
13 understand is that they very clearly intend to
14 comply with the settlement agreement. That
15 they have no intention of breaching it.

16 THE COURT: Then you tell me how
17 mechanics could be put into place to avoid what
18 appears to be an unexpressed reservation of
19 agenda?

20 MS. BUTERA: Your Honor, we think
21 that very clearly a retraction can be put into
22 place and the precise terms of the settlement
23 that was read on to the record could be
24 published along the lines of the proposal that
25 we have made, which basically just bullets

1 LIONEL, LLC
2 points right from the transcript so there can
3 be no spin placed on this. That's really what
4 we are talking about here, a spin that was
5 placed on it.

6 THE COURT: There may be damage
7 already occurred by that press release and it's
8 been expressed in all of this correspondence
9 that there is some confusion in the marketplace
10 as a result of this.

11 MS. BUTERA: Your Honor --

12 THE COURT: This is an element of
13 damage here.

14 MS. BUTERA: Your Honor, if that is
15 truly the case, which we would like to fully
16 brief this issue, if that is truly the issue,
17 we are not saying that it is, but if it is,
18 certainly a retraction and a publication of the
19 precise terms that were agreed upon in court
20 transcribed so that there can be no mistake as
21 to what was said and what wasn't said would
22 fully rectify it.

23 THE COURT: Since the Court is a
24 participant on how to make a finding that this
25 settlement was in the best interest of the

1 LIONEL, LLC

2 estate, any kind of retraction it would appear
3 to me should be a joint press release agreed to
4 by both sides so that there are no further
5 press releases to put any kind of spin on it.

6 But further than that, the Court is
7 concerned that when I so ordered the record
8 with respect to a consent judgment and what I
9 understood to be material terms that were part
10 of that order, that record that was so ordered,
11 that those be implemented immediately so that
12 there was no further side-stepping.

13 For example, there is no reason why
14 some of the elements of the settlement cannot
15 be papered immediately, but we agree.

16 THE COURT: A promissory note, for
17 example, the security for the promissory note.

18 MR. BUTERA: But we agree.

19 THE COURT: The statement or
20 acknowledgment who has the rights to
21 technology, all of this can be done today.

22 MS. BUTERA: We agree, your Honor,
23 and the very next day called to determine where
24 the paperwork was so we could make sure that
25 that was, in fact, put in place right away and

1 LIONEL, LLC

2 we would be more than willing to work with
3 O'Melveny in getting an appropriate press
4 release and we would agree that there should be
5 no other press talking about the settlement in
6 any way, shape or form.

7 THE COURT: What about documentation
8 executed forthwith?

9 MS. BUTERA: We would certainly
10 agree to that, your Honor.

11 MS. CENDALI: Your Honor,
12 interestingly enough we have asked them and
13 said as a basic part of the settlement we
14 pressed them we needed to have immediately the
15 next day the documentation showing that the
16 collateral that was as you know a big part of
17 the hearing really existed and that we weren't
18 in an illusory situation being told that
19 Mr. Grubba was pledging stock that he really
20 didn't have and wasn't there.

21 We didn't receive any of this
22 documentation. We didn't receive anything on
23 the collateral. That's one point.

24 Second, Miss Butera did not indicate
25 or address the basic problems we have with

1 LIONEL, LLC

2 regard to the lack of meeting of the minds.

3 Her statement to you, your Honor,
4 just now indicated that she has the belief that
5 her client may continue to manufacture and
6 flood the market with more goods when we
7 thought it was clear that all they had was a
8 limited sell-off period so that they wouldn't
9 have to have --

10 THE COURT: If we are going forward,
11 I can deal with that issue very easily but
12 that's interpretation.

13 MS. CENDALI: It is not a question
14 of interpretation. It is what we thought the
15 deal was.

16 THE COURT: I'm not talking about
17 that. I'm talking implementing certain
18 elements of Rule 65.

19 You want to be heard, Mr. Halperin?

20 MR. HALPERIN: Please, your Honor.
21 That is a very, very important and material
22 point and there is no way we got to it but we
23 got to it a little faster than I expected.

24 From the Committee's perspective the
25 cessation of manufacturing of infringing goods

1 LIONEL, LLC

2 particularly inasmuch as we are going to be
3 approaching the Christmas season very soon and
4 preventing K-Line's uses of Lionel's technology
5 from flooding the markets, people say, look,
6 the K-Line engine sells for several hundred
7 dollars less, I will buy that because the
8 budget is a little tight this year, than the
9 Lionel's version, this is a hugely important
10 issue from the Committee's perspective.

11 This goes to the value of Lionel.
12 This goes to the value that was generated at
13 some point for the creditors and we are very
14 concerned that this is an enormous issue and
15 would enormously impact Lionel.

16 It was clear to us on Friday and
17 last week, and if this is not clear here, that
18 there is no meeting of the minds; that there
19 was to be no more manufacture.

20 I will even go a step further and
21 advise the court from the Committee's
22 perspective, we had discussed with the debtor
23 what about pulling the infringing goods from
24 where they were. We were told that, in fact,
25 they can't because these are true sales to the

1 LIONEL, LLC

2 various distributors but we were assured it was
3 a very limited number.

4 This would totally vitiate the
5 settlement if they had the ability to continue
6 to manufacture infringing goods and sell it
7 into the market. There would be no meeting of
8 the minds.

9 Two other points I want --

10 THE COURT: It was this Court's
11 impression with respect to the settlement that
12 it involved just working through the existing
13 inventory.

14 MR. HALPERIN: That is what we had
15 consented to. Judge, there were two other
16 points I just wanted to note quickly.

17 First, there is a statement in one
18 of the K-Line's letter, and I apologize because
19 there were so many flying I may not have it
20 properly identified, but there is a statement,
21 "This court is aware no such admission
22 contained in the first bullet point above is
23 part of the settlement."

24 Second, there are no money damages
25 awarded to Lionel and Klein and Grubba and they

1 LIONEL, LLC

2 agree to be jointly and severally liable for
3 any money damages awarded to Lionel.

4 Well, after the Court had indulged
5 us for a brief recess to address the collateral
6 issue when I had addressed the Court to the
7 fact the committee was finally okay with the
8 terms we have accompanying as collateral -- let
9 me find the page.

10 Page 31 of the transcript I had
11 addressed the Court, and five or six lines into
12 the comments that I made, I indicated the joint
13 and several obligation will also be
14 collateralized by Mr. Grubba's interest in
15 Broadway, Ltd. and Precision Scale model to the
16 extent legally possible. We go on.

17 Now, your Honor, when we concluded
18 that subsequent little piece, your Honor went
19 back to the defendants and said to them again:
20 "Mr. Grubba and Mr. Klein, is that your
21 understanding that's just been described into
22 the record?"

23 "MR. GRUBBA: Yes.

24 "MR. KLEIN: Yes."

25 And then the Court was concerned

1 LIONEL, LLC

2 that one of them couldn't be heard and again
3 they reiterated yes, and your Honor so ordered
4 the record.

5 So to now say there was no joint and
6 several obligations and we are talking up to a
7 \$700,000 monetary issue is just wrong. It is
8 inaccurate and it is wrong.

9 There is also a statement in the
10 Rivkin letter I'm assuming was nothing more
11 than an error in typing, but there was, one of
12 the letters contained a list of points, and I
13 suppose this was to be the subsequent press
14 release, and if your Honor looks at paragraph
15 11 on page 2 of that substitute press release.

16 THE COURT: I had noticed it. I
17 have it outlined as well.

18 MS. BUTERA: Precision was left out
19 as well. I'm assuming it was a typo, but it
20 was transcribed right from the court record,
21 your Honor, by a secretary and looks like some
22 words were messed up.

23 MR. HALPERIN: We were all very
24 clear on the record. I assumed it was a typo,
25 but it is --

1 LIONEL, LLC

2 THE COURT: There is also a negative
3 in that paragraph that I don't think was
4 intended.

5 MR. HALPERIN: Suffice to say we are
6 in agreement with your Honor's interpretation.

7 Miss Cendali did a very good job of
8 the back and forth. We read the transcript.
9 We read the press release. We think there are
10 a lot of inaccuracies here and we do have a
11 concern there's no meeting of the mind.

12 MS. BUTERA: Your Honor, may I
13 briefly respond, please.

14 This issue on manufacturing of sale,
15 these are the words that were used to outline
16 the settlement on the record.

17 Now, the first, at the very outset
18 of what was going to be agreed upon it says
19 that the consent judgment will enjoin them, the
20 defendants, from making or selling any
21 products, from making or selling any products
22 containing Lionel technology at issue in this
23 case specifically, and it lists the products
24 and then it says this injunction though will
25 not go into effect until January 31 of 2006.

1 LIONEL, LLC

2 Now, the reason that's important is
3 because when we, indeed, were negotiating the
4 settlement, there was discussion about how we
5 could have a transition period through January
6 31, 2006, at which point, indeed, the
7 defendants would stop all making, selling,
8 anything to do with the products.

9 However, there were some products
10 that were in the production line so that
11 production had already commenced and so that
12 was why the injunction was not going to go into
13 effect until January 31, 2006.

14 So before when we were having this
15 discussion, and I said that's an interpretation
16 issue because the language is here, and this
17 was language that the plaintiff's counsel put
18 together when we were documenting what the
19 meeting of the mind was of the parties. So,
20 your Honor, there has been a meeting of the
21 minds.

22 You know, to the extent they are
23 trying to change the terms, that's a completely
24 different issue but clearly there was a meeting
25 of the minds. There was --

1 LIONEL, LLC

2 THE COURT: I can't fully agree with
3 that because as the court arbitrator here it
4 was the Court's impression that the January,
5 2006 date was to give you time to work through
6 just the inventory but that you weren't going
7 forward because if that was not the case then
8 inventory could have been manufactured in
9 December of 2005 and still probably or possibly
10 could be sold thereafter.

11 So it does appear that if that's
12 your position, then maybe there was no meeting
13 of the mind.

14 MS. BUTERA: I don't think so, your
15 Honor, because, again, the defendants -- this
16 was language that was specifically worked out
17 with the other side now.

18 If they are saying that their view
19 of those words is that it was only going to be
20 selling, well, then, that's something that we
21 will have to address.

22 MS. CENDALI: Well, what was said to
23 the court record at this point, your Honor, by
24 me was that after they admitted that
25 Mr. Pierson was inappropriately hired by

1 LIONEL, LLC

2 Lionel, that Lionel technology was used without
3 Lionel's permission, that Lionel technology
4 was, in fact, used in K-Line's products and
5 that the technology was owned by Lionel, I then
6 said that and K-Line has no right, title and
7 interest in that technology other than their
8 right to continue sales through January 31,
9 2006, to continue sales. That was the only
10 right they were to continue on that.

11 THE COURT: On this issue, it does
12 appear that there was a lack of the meeting of
13 the minds. So unless the parties can agree on
14 a joint statement, resolve this issue, and I
15 will give you five minutes to confer, we will
16 resume this conference, which has been called
17 for the purpose of implementing Rule 65, which
18 as I indicated I am prepared to do in many
19 different respects.

20 MS. BUTERA: Okay, your Honor. We
21 will confer.

22 THE COURT: Are there any other
23 areas or issues that you want to deal with?
24 There is one issue that you should consider and
25 that's the Court's issue.

1 LIONEL, LLC

2 In view of the fact that there does
3 seem to be a history here of a gray area under
4 which parties are operating, and now I'll say
5 this for both sides, the Court's quite
6 concerned that anything that is agreed upon
7 that you work out be capable of being monitored
8 and implemented immediately.

9 So we don't have to come back, and
10 that is some of the documentation can be and
11 should be executed forthwith and, as I
12 indicated, it seemed to me that the easiest
13 thing to deal with is to paper the promissory
14 note and the collateral that's supposed to be
15 working with that.

16 MS. BUTERA: Okay. Thank you.

17 THE COURT: And that includes the
18 immediate transmission of the appropriate
19 information that had been requested with
20 respect to the collateral.

21 MS. BUTERA: Yes, your Honor. We
22 will, with all due respect.

23 (A recess from the record was
24 taken.)

25 THE COURT: Ladies and gentlemen.

1 LIONEL, LLC

2 MS. CENDALI: Hello, your Honor.

3 Would you like me to report on the last
4 extended five minutes?

5 THE COURT: Sure.

6 MS. CENDALI: I'm hopeful that the
7 parties have worked out their remaining
8 differences.

9 Dealing first with the deal terms on
10 the subject of joint and several liability, the
11 concept is that the individual defendants would
12 stand behind the obligations, the exact words
13 as to how that is going to be worked out will
14 be agreed to in consultation with the
15 Creditors' Committee, but the concept that they
16 will be liable will stand behind the
17 obligations is a material point of the
18 settlement.

19 Second, with regard to the point on
20 manufacturing, K-Line and Lionel and the other
21 defendants have agreed to your Honor entering
22 right now a new or modified preliminary
23 injunction or a permanent injunction actually
24 making clear that defendants are prohibited
25 from manufacturing any more of the infringing

1 LIONEL, LLC

2 products.

3 There is an issue that has arisen as
4 to products that they may have already
5 completed and might possibly be on a boat from
6 Asia. They are going to provide us with
7 information tomorrow as to the unit of those
8 products.

9 Our impression was that this was a
10 very small number. If it turns out to be a
11 very small number, I don't think we will have
12 an issue and we will let the products that are
13 on the boat arrive and be sold during the
14 sell-off period.

15 If it turns out that it is a bigger
16 number than anticipated, we may have to go back
17 to the table a little bit about that, but in
18 any case, the concept is that the parties, the
19 defendants have consented to your Honor's entry
20 today of an injunction making clear that they
21 are not to manufacture any more of the
22 infringing products.

23 Another point counsel points out is
24 that there may be some products at the
25 warehouse at Sanda Kan in Asia that have been

1 LIONEL, LLC

2 completely finished but have not yet been put
3 on the boat and again the same principal
4 holds.

5 If we are only talking about a de
6 minimis amount of product, then we don't have
7 an issue of that but what we are really
8 concerned about is making sure there is not a
9 loophole to flood the market with newly
10 manufactured goods.

11 With regard to papering the deal, we
12 need to see right away the material with regard
13 to the collateral to make sure that that is an
14 illusory form of consideration for us and they
15 promised to do that.

16 We also agreed to be able to get to
17 them the notes and the other documentation that
18 would be this to try to get as much of the deal
19 in place as quickly as possible, and then,
20 finally and from our point of view, probably of
21 most material importance is that the parties
22 have agreed to work on a joint press release
23 that will be issued as soon as possible that
24 will -- and we have also agreed that the nature
25 of the press release in light of the fact that

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there's already the pre-existing K-Line press release that's caused confusion and damage in the marketplace, that the joint release will do more than just simply recite the terms of the deal but will affirmatively help to clarify for the public the nature of the deal and what the parties had intended in order to make sure that the misimpressions that had been generated have been clarified.

The idea though is that we will get reasonable comments and talk back and forth and try to come up with something that does undue the harm that was done.

We have also agreed that we will agree that in the settlement agreement there will be a new form -- that the release will be extended to include any release that people may have with regard to press releases, and we're committed to working on that in very short order because, again, from Lionel's point of view, the message out there to the public was the central reason that it had agreed to the settlement; and if we cannot reach agreement later today on that, effectively there has not

1 LIONEL, LLC

2 been a deal.

3 But I'm very hopeful with the
4 parameters we have worked out in the hallway
5 that we do have an understanding and that we
6 will be able to put pen to paper and discuss it
7 and end up with a final resolution, your
8 Honor.

9 THE COURT: Does anyone else want to
10 be heard?

11 MS. BUTERA: Your Honor, just very
12 briefly.

13 What we have agreed to work on has
14 been accurately reflected. I just want to
15 clarify two quick points.

16 The joint several liability issue
17 was as to the note and that language is going
18 to be detailed in the note that is going to be
19 provided from MDK to the plaintiff debtor.

20 The only other thing was on the
21 press release. We have agreed that we will
22 work on a joint press release which seeks to
23 clarify any statements that have been perceived
24 to be inaccurate or misleading by the plaintiff
25 debtor. Thank you, your Honor.

1 LIONEL, LLC

2 THE COURT: Anyone else want to be
3 heard?

4 MR. HALPERIN: Your Honor,
5 obviously, the settlement is going to be in the
6 details but I think it was fairly explicitly
7 detailed in the discussion in the hallway as to
8 what the shape and the form of the press
9 release will be. I am hopeful that we will be
10 able to get over this.

11 In terms of the words "joint" and
12 "several liability," we will look at the
13 documents. Everybody knows it is what it is.

14 The Committee has no issue of
15 granting a release with the things that have
16 happened through this date in terms of what
17 people may see as future breaches or anything
18 of that nature.

19 The law is what it is, if it ever
20 comes up. Hopefully, it won't.

21 MS. BUTERA: I forgot to mention one
22 other thing.

23 May I be heard for one other
24 moment?

25 THE COURT: Sure.

1 LIONEL, LLC

2 MS. BUTERA: The Court had mentioned
3 no further press releases and we would
4 absolutely be in agreement on that as well.

5 MS. CENDALI: There has been no
6 discussion in the hallway on the subject of no
7 further press release.

8 What we talked about we don't
9 envision any further press release but we have
10 to deal with the fact we are in the world where
11 the executives are asked to comment and give
12 lots of questions on this.

13 Lionel cannot be put in a position
14 of never being able to make any comments with
15 regard to this case when asked by the
16 innumerable people out there in the trade press
17 on this.

18 I think comments need to be
19 consistent with the ultimate joint press
20 release that is agreed to. That's fair, but we
21 will not consent, your Honor, to a gag order, a
22 gag order, of your own, then we would, but a a
23 gag order suggested by defendants on our
24 ability to answer truthfully questions, and
25 that was not something we had agreed to.

1 LIONEL, LLC

2 THE COURT: Well, if you implement
3 an appropriate press release, and you are not
4 far from that when you use as a basic the
5 proposed press release from the defendant as
6 sort of a cornerstone, you can build around
7 that and, no, I will not issue a gag order but
8 it would seem to me that you should take the
9 time and trouble with all the talent that's
10 here putting together a press release that does
11 not require further elaboration back and forth,
12 charges and countercharges and reexplanation.
13 It seems to me that we all should be capable of
14 doing that.

15 MS. BUTERA: Thank you, your Honor.

16 THE COURT: But I have another
17 problem with all of this.

18 We're here again and again and again
19 papering.

20 This is apparently something that
21 should not not take a long period of time but
22 in view of the polarity that has occurred in
23 getting to this particular point, I am still
24 quite concerned about the ability to put this
25 together very quickly and appropriately.

1 LIONEL, LLC

2 The conditions precedent to a full
3 agreement are somewhat subjective. The concept
4 of having to be satisfied or reviewing
5 proposals or understanding as to where things
6 are or are not are such that I don't know that
7 you really have an agreement today.

8 Accordingly, I'm going to schedule a
9 hearing for purposes of the preliminary
10 injunction for a week from Wednesday.

11 If in the interim the parties put
12 together the settlement, the agreement and do
13 all of the documentation, you can let the Court
14 know and we don't have to go forward.

15 One of the reasons I'm putting this
16 imperative on all of you is that at the prior
17 hearing witnesses were here. There was a trial
18 ready to proceed. Witnesses were brought in
19 from out of the country. They are no longer
20 here. There is the allegation that there's
21 been a material breach and it is not merely a
22 colorable allegation.

23 If there is one that has a fair
24 amount of substance to it so that in the event
25 that there cannot be an agreement, as I

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LIONEL, LLC

2

indicated early this morning and

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parenthetically we will talk about early this

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morning, this has not been a five minute recess

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although the record only says that.

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It is several hours since I gave you

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five minutes and the court reporter is looking

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at his stomach and wondering why he's still

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sitting here, but in view of all of that, I

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indicated to you that I was concerned about

Rule 65.

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If in the interim now and a week from Wednesday, which will be a rule 65 10-day period unless I miscalculate, it is of concern that the parties are not prepared to come to a complete accord, in other words, subjective terms that have been spelled out here have not been agreed to, you can contact the Court and based upon the entirety of the record to date, including all the correspondence, the hearing we had last week and today's conference, this Court would be receptive to entertaining a request for a temporary restraining order.

MS. BUTERA: Your Honor, may I just ask, I have every belief that the parties

1 LIONEL, LLC

2 indeed will be able to arrive at a complete and
3 final deal with all appropriate paperwork, et
4 cetera, but I would just ask that at that time
5 if there is going to be a hearing, at that
6 time, the defendants not now but could at that
7 time renew any motions that has been pending
8 before your Honor as well?

9 MS. CENDALI: I don't understand
10 what that's a request for. The only motion I'm
11 aware of is our motion --

12 THE COURT: They have a motion with
13 respect to discovery, and that motion is
14 completely muted by the settlement that took
15 place at that time and I don't know that it is
16 acceptable of being renewed de novo because the
17 facts it was now based on is extinct, so your
18 application is denied.

19 MS. CENDALI: The only other thing I
20 wanted to make clear, your Honor, in the
21 hallway we had mapped out in some detail
22 exactly what the proposed press release was
23 going to be and the parameters that the parties
24 had agreed as to what would be acceptable to
25 them, and I believe there is no shortage of

1 LIONEL, LLC

2 lawyers who would be witnesses to that, and the
3 press release that we will ultimately agree on
4 needs to be consistent.

5 THE COURT: I've given you as a
6 marker a date, a week from Wednesday.

7 MS. CENDALI: That is right.

8 THE COURT: If it all apparently
9 comes close to some accord, although as I
10 pointed out many of the conditions to an accord
11 are somewhat subjective, so, therefore, you
12 really don't have a settlement today, I'm
13 giving you the opportunity to achieve what you
14 indicate in good faith you intend to achieve
15 and I hope you can do.

16 MR. CENDALI: Thank you, your
17 Honor. The only thing I believe we do have an
18 agreement that your Honor -- your Honor had
19 already issued an injunction last week and I
20 believe we do have an agreement with defendants
21 on consent for your Honor to modify that to
22 make clear that they are not entitled to
23 manufacture any of the products during this
24 sell-off period and we had agreed to that, that
25 your Honor would be doing that today.

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Counsel can correct me if I'm wrong and I guess what I want to make sure is that since I believe that was the understanding and it would be on consent that that be obtained today.

MS. BUTERA: Your Honor, this is all subject to agreement on all of these points and we would immediately work to get that agreement I would hope.

THE COURT: Why don't you take another five minutes, and if that's a very key issue and, as I indicated, based upon an appropriate request, I might consider a temporary restraining order based upon the entire record to date.

THE COURT: Five minutes. Off the record.

(Discussion off the record.).

(A break from the record was taken.)

MS. CENDALI: We did, your Honor, and on behalf of all counsel, we ask you do take judicial notice this time it was really less than five minutes.

In any case, we have clarified our

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understanding and agreement that the parties would like your Honor respectfully to issue a consent decree in judgment -- a permanent injunction on consent today amending your previous order to that effect of last Tuesday but making clear that they were to be enjoined from any manufacturing during this for all time.

However, we also want to make clear that to the extent, we hope unlikely, but to the extent that the settlement is not able to actually be achieved with all the Is and Ts are dotted and crossed, at that point obviously there would not be an injunction on consent as there wouldn't be a settlement; and at that point while the consent judgment would still be in effect so there is no gap period it would be our intention to come to your Honor and respectfully request that a TRO be executed pending a preliminary injunction hearing.

In other words, we want to make sure that the consent judgment on manufacturing is input today as the parties had agreed while recognizing that if the settlement disappears

1 LIONEL, LLC

2 that judgment on consent would be effectively
3 dissolved at the appropriate time subject to
4 whatever injunction your Honor may wish to
5 issue later in the case.

6 THE COURT: Well, we're operating in
7 that regard under Rule 65 so it is a 10-day
8 period.

9 MS. CENDALI: That is right.

10 MS. BUTERA: We understand.

11 THE COURT: Let me hear from both
12 counsel as to the consent nature of the parties
13 all here.

14 MS. BUTERA: Yes, your Honor. That
15 is correct. We are agreeing to that
16 preliminary injunction as to manufacture on
17 consent subject to the parties working out this
18 settlement, which it has been settled. It is
19 just documenting it and agreeing to the press
20 release, the joint press release, your Honor.

21 THE COURT: Well, that's fine for
22 me, too, so order this recorded and I am
23 prepared to so order the record and I think
24 that you should give me a document sometime
25 today because all of the papers, and I can

1 LIONEL, LLC
2 identify some of the items which are
3 proprietary by description, they come into
4 several categories, three or perhaps four, and
5 that should be part of the document that you
6 submit to me this afternoon.

7 But based upon this consent, the
8 principal is here. Are both principals here?

9 MS. BUTERA: Actually, your Honor,
10 Mr. Klein from MDK is here. Mr. Grubba is not
11 here but we have a telephone number. He's in
12 Florida and if we wished, we could get on him
13 on a conference call with the Court, but we
14 have spoken with him and he has consented and
15 we can represent that he has consented.

16 THE COURT: Well, the consent at
17 this point is with respect to continued
18 manufacturing?

19 MS. BUTERA: That's correct.

20 THE COURT: And that's why the
21 corporate debtor.

22 MS. BUTERA: Yes.

23 THE COURT: Mr. Klein, do you
24 understand? You've conferred with your
25 counsel?

1 LIONEL, LLC

2 MR. KLEIN: Yes.

3 THE COURT: And you are in full
4 accord with the proposal?

5 MR. KLEIN: Yes.

6 THE COURT: And the prohibitions
7 with respect to the continued manufacture of
8 the items in question?

9 MR. KLEIN: Yes, I am.

10 THE COURT: Again, this record is so
11 ordered. Submit the following document.

12 MS. CENDALI: Thank you, your
13 Honor.

14 MS. BUTERA: Thank you, your Honor.

15 (Time noted: 1:25 p.m.)

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C E R T I F I C A T E

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Shorthand Reporter and Notary Public of the
State of New York do hereby certify that the
foregoing is a true and accurate transcript of
the within proceedings, to the best of my
ability.

Michael Williams

MICHAEL WILLIAMS, CSR

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